Marketing Dynamics In The Australian Private Hospital Industry

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Abstract

This is the first stage of a project designed to better understand the business and marketing dynamics of the private hospital industry in Australia. This stage will use a strategy framework to analyse the main forces at play in the industry. It will attempt to make an objective assessment of the operating environment for industry members. Data for this first stage will be taken mainly from a range of secondary sources. The paper will discuss the industry, and will conclude with future research streams, primarily from a services marketing perspective.

Industry Overview

In order to ultimately answer the research question "what are the business and marketing dynamics of the private hospital industry in Australia?" it is important to address the Industry and marketing principles. The underlying driver of the demand for health services will be the ageing Australian population. With a current median age of about 35 years (a 14% rise over the past 15 years), it is expected to rise another 14% to a median age of 40 years by 2016 (Macquarie Research Equities 2003). This trend provides a strong basis for the projected growth and development of private health services. In Australia there are 748 public hospitals and 549 private hospitals. In these hospitals there are 52,000 licensed beds in the public sector and 27,000 in the private sector (Citigroup 2005). Private sector health care relates to the provision of hospital services in non public hospitals. The most recent statistics available are for the 2002-03 year and show that nearly four out of ten hospital patients in Australia were admitted to private hospitals, representing nearly one-third of all days of hospitalisation. There were 536 private hospitals in operation during 2002-03 made up of 271 acute hospitals, 25 psychiatric hospitals and 240 free standing day hospitals facilities (ABS 2004). 2.6 million patients were admitted in 2002/ 3, being hospitatlised for a total of 7.2 million days. 47 5000 staff are employed in the private hospital sector (ABS 2004). The average number of beds available in acute and psychiatric hospitals during 2002-02 was 24, 454, a decrease of 1% from the previous year. The average number of beds per hospital rose from 82 in 2001-02 to 83 in 2002-03. Almost 74% of available beds in private acute and psychiatric hospitals during 2002-03 were in hospitals within the Capital City Statistical Divisions where 64% of Australia's population lived. In 2002-03, private acute and psychiatric hospitals had an occupancy rate of 75.6% (75.2% in 2001-02). Religious or charitable institutions (Not for profit sector), provided 37% of the available beds in 2002-03 and had the highest occupancy rate of 77.5%. Growth in the demand for private health services has exceeded the growth rate in the public sector during the 1990's, with its share of total expenditure on hospital services increasing from 18% in 1992/93 to 22% in 1996/97.

Contracting Framework

An important aspect of understanding the operating environment of the private health industry is to know the operating framework of the key players participating in the delivery and payment system of private health services.

The Health Fund-Private Hospital dimension - Given that the bulk of private hospital revenue comes from treating insured patients, negotiations between a hospital and the health insurance funds can have a crucial bearing on a hospital or health provider's financial performance and its ongoing viability. Negotiations between the two determine the rate a private hospital receives for various services provided to health fund members (Productivity Commission 1999). It has been observed that the health funds can be ruthless in these negotiations (Moriarty 2004)

The Private Hospital- Doctor dimension - The relationship between private hospitals and doctors is fundamental to service delivery and the operation of all private hospitals. It also has an important impact on the viability on the private hospital business even to the extent of providing some with a decisive competitive advantage (Macquarie Research Equities 2003). For example, Doctors determine the type and extent of services to be administered, often determine where the service will be delivered and are involved in the actual delivery or supervision of the services delivered. Agreements between private hospitals and doctors often cover conditions of supply and use of premises and medical equipment. These agreements tend to be medium to long term and are referred to as Practioner Agreements which enables hospitals to receive payments under Hospital Provider Agreements for services provided by doctors to patients. The nature of agreements made will reflect the negotiating power of both parties. For example particular hospitals may be located near critical patient supply markets such as large public hospitals and dense population centres. Some doctors may be dominant in the supply of key medical services and hence be critical for the design of a hospital's case mix and /or patient appeal.

The Health Fund-Doctor dimension - Contracts between Health Funds and doctors are generally outside the influence of Private hospitals. Doctors have a key role in the economics of health fund economics as they usually specify the type and frequency of the services to be delivered, also deciding on the length of stay in a hospital's facilities. A 1997 survey indicated that doctors determined the institution used to deliver health services for 64% of admissions (Quints and Marks 1997).

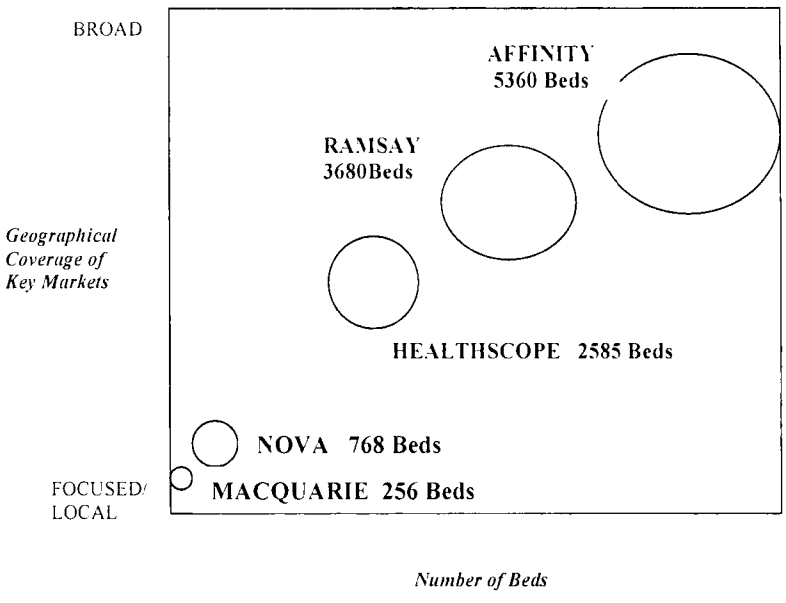
Industry Dynamics

In order to understand the context of the private hospitals industry, it is useful to undertake an analysis of the key forces and dynamics at a point in time. One framework that can be used to structure this process is the five forces model (Porter 1980). Here, the competitive landscape is at the central point of focus which examines the nature and details of how the key firms compete in the industry. Potential entrants and likelihood of entry to and exit from the industry are shown at the top of the diagram. The role and threat of substitute products and service is considered at the base of the figure. The impact and bargaining power of buyers is positioned at the right side of the chart. The impact and bargaining power of suppliers to the industry is positioned at the left side of the chart. This paper will use the five forces framework as the basis for review and discussion of the Australian private hospital industry. In the for profit sector, the largest market share is owned by Affinity with 5360 beds (42%). This is followed by Ramsay with 3680 beds (29%). Healthscope holds a 20% share, with 2585 beds. Nova Health, with 768 beds, holds a 6% share, and finally with just 2% share is Macquarie Health, with 256 beds. The competitive landscape would have looked different to this if Ramsay had been successful in acquiring the Affinity beds in 2003 from the Mayne Group. If this had occurred, then it is unlikely that the Benchmark acquisition would have happened as it did in 2004. Under this scenario, Ramsay could have had a bed market share

near 70% (say 8105 beds), Heallthscope with about 22% share (2585 beds), leaving Benchmark with 8% market share. More recently, it has been estimated that Affinity has 5367 beds; Ramsay 3967 and Healthscope 2400 (Greenblat 2004). It would normally be expected under such conditions of concentration that competitive rivalry would be intense in an effort to maintain individual market shares. However, competitive intensity is modified due to the unique geographical positioning of each company's hospitals, which are located strategically near the markets, which yield both patients and medical referrals.

It has been observed that; "Few private hospitals in major Australian cities could consider themselves to have a dominant market position- most treatments are available in several private and public hospitals" (Productivity Commission 1999). From a marketing perspective, this means that private hospitals do not intensely compete on price or the type of service offered, but rather based on geographic segmentation, which substantially reduces the need to aggressively differentiate with product, service and brand strategies. It also has an impact by way of containing the level of competitive marketing expenditure necessary to maintain the desired level of bed occupancy in specific locations. For private acute and psychiatric hospitals, the average annual growth rate for the last five years is reported to be 6% (ABS, 2004). Net operating margin levels and growth are key indicators of the industry's business and marketing effectiveness and appeal to investors. For acute and psychiatric private hospitals during 2002-03, the net operating margin was reported to be 6%, steady at the level of the previous year but above the average margin for the five years to 2002-03 of 5% (Australian Bureau of Statistics, 2004). Relative positioning of the five competitors in the for-profit listed private hospitals can be viewed from the perspective of their size in terms of beds and their geographical coverage or proximity to primary markets.

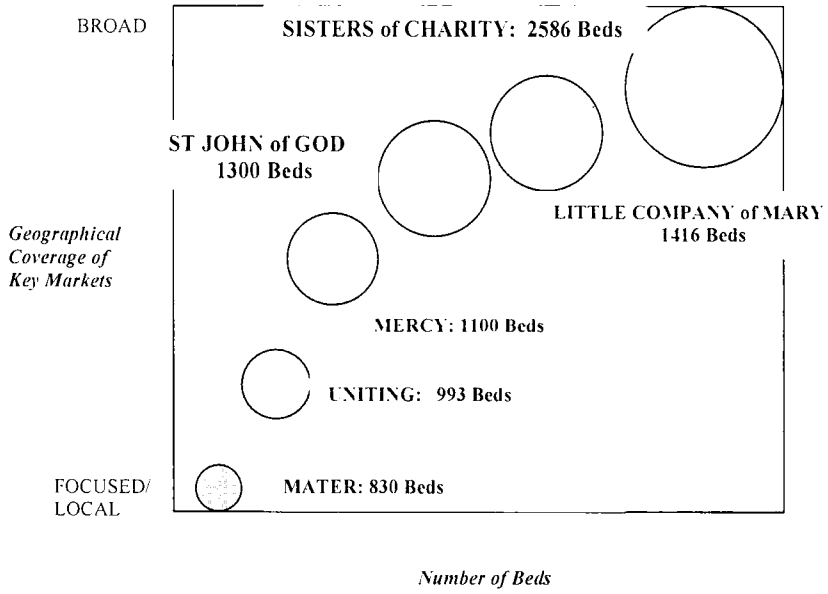
Figure C ***Relative Positioning of Private Hospital Companies; For Profit, Listed Companies (Psychiatric and Acute Care)***



Non Profit Private Hospitals are operated by religious or charitable institutions. For the year 2002-03, religious or charitable hospital groups accounted for 37% of the available beds in acute and psychiatric private hospitals. Their bed occupancy rate of 77.5% for 2002-03 was

higher than for acute and psychiatric bed occupancy in the private hospital group overall (ABS 2004).

Figure D ***Relative Positioning of Private Hospital Companies; Not-For Profit, (Psychiatric and Acute Care)***



Key observations

Some key summary observations from this analysis are as follows;

- Key changes to industry structure and numbers has occurred mainly in the for-profit sector of the industry. Consolidation in this sector leaves three main listed companies (Affinity, Ramsay and Healthscope) with 48% of the total private hospitals beds in acute an psychiatric care.
- Each private hospital group or company tends to have unique positioning near key markets and referring doctor networks. This unique positioning limits the competitive rivalry between the companies in the industry. It also has the effect of containing the level of marketing spend and minimising the necessity to reduce health service prices in order to attract customers.

Implications for marketing & future research

Following on from this analysis, what are the implications for marketers and managers in the private hospital industry? A major and constant focus on profit margin management: there are strong pressures from the health insurance funds to contain prices charged for hospital services. There also very strong pressures on the private hospital cost dimension by the key supplier groups of products and services to the industry, namely medical practitioners, nursing staff and medical equipment suppliers. Hence a critical and ongoing management skill is to run hospital operations to acceptable quality standards with less costly resources is constant operational innovation. Another dimension of margin management is to actively manage case mix by increasing the proportion of services with higher profit margins. Strategic management skills will become more critical as pressure builds to find future revenue and growth opportunities. These opportunities will come through varying

combinations of: the successful introduction of new products and services, increased penetration to high priority market segments, or accessing new markets not currently being served. These opportunities may be in areas closely related to the existing business definition such as,; diagnostics, post treatment services, enhanced in-hospital services etc. They could also include opportunities more diverse from the traditional private hospital business such as; aged care, preventative health care, 'wellness' and disease prevention services. The ability to make strategic change a reality will be dependant upon applied marketing skills. As strategic priorities are established, detailed marketing objectives and strategies need to be formulated and implemented with cost accountability and key performance indicators used for tracking and monitoring progress. Given the power distribution of key stakeholders in the industry, a key ongoing management skill and process will be the effective management of relationships with key supplier groups such as the medical practitioners, health insurance funds and equipment suppliers. Ongoing and proactive relationship planning and actions will be fundamental here so that issues are resolved in a timely and cost effective manor and to ensure that crisis or ad hoc solutions are avoided as much as possible.

Differentiation seems to be an issue that health care marketers are facing, with little ability to distinguish from one to another. Geographic segmentation seems to be the most appropriate form of target market selection, however issues unique to services (intangibility, perishability, inseparability, heterogeneity and personal nature) (Pride and Ferrell, 2004) definitely apply when marketing health care. Market oriented systems seem to be a requirement in health care now, where regulation and planning is becoming important, as healthcare moves towards a more competitive model (Ham et al 1990). This can only be addressed by understanding the role of the consumer in the system (John, Gabbott and Hogg, 1998). In answering our research question, it is evident that much of the theory relating to services marketing can be applied to the health care industry. Future research will link this study into issues with services marketing, particularly in terms of the characteristics that are unique to services, situational factors and also gap analyses.

It is likely that changing government health policy and strategy both at the Federal and State level will impact on management in this sector. Furthermore, it is expected that there will be further industry consolidation as individual companies attempt to achieve growth targets, gain effective market coverage, reduce market area competition, and gain from the benefits of economies of scale (eg operating efficiencies, bargaining power with suppliers and health funds). Rising costs and pressures on revenue will also cause a squeeze on profit margins, ultimately causing industry members to diversify from the traditional core business in their attempts to achieve growth targets, diversify risk, and build profit margins and return on investment. Marketing cannot be ignored in the health care sector, particularly as competition increases, and industry players merge.

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